Supreme Court of the United States

OCTOBER TERM, 1943

No. 52

WILLIAM J. DEMOREST, JR., ANN DEMOREST and CAROLYN DEMOREST by GERALD P. CULKIN, THEIR SPECIAL GUARDIAN,

Appellants,

against

CITY BANK FARMERS TRUST COMPANY, as Trustee under the will of Henry C. West, Deceased, *et al.*,

Respondent.

BRIEF FOR RESPONDENT TRUSTEE

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Of Counsel.

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No. 32

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Appellants,

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BRIEF FOR RESPONDENT TRUSTEE

Opinions Below

The opinion of the Court of Appeals (R. 117) is reported in 289 N. Y. 426 and the dissenting opinions (R. 122 and 128) are reported in 289 N. Y. 432, 437.

The opinion of Surrogate FOLEY in the Surrogate's Court of New York County (R. 93) is reported in 175 Misc. 1044.

The Appellate Division of the Supreme Court affirmed the Surrogate's decree without opinion (R. 114), 264 App. Div. 701.

Jurisdiction

The jurisdiction of this court rests on Section 237(a) of the Judicial Code as amended by the Act of February

13, 1925, Chapter 229, 43 Stat. 936 [28 U. S. C. A. Sect. 344(a)], which confers jurisdiction on this court to review a final judgment or decree, in any suit in the highest court of a State, where there is drawn in question the validity of a statute of such State on the ground of its being repugnant to the Constitution of the United States, and the decision is in favor of its validity. The right of review on appeal, instead of a writ of error, was conferred by the Act of January 31, 1928, Chapter 14, Section 1, 45 Stat. 54 and the Act of April 26, 1928, Chapter 440, 45 Stat. 466 [28 U. S. C. A. Sect. 861a, 861b].

Question Presented

The question presented is whether Subdivision 2 of Section 17(c) of the Personal Property Law of New York deprives the appellants of property without due process of law, and, therefore, violates the Fourteenth Amendment of the Constitution.

The statute establishes rules of administration with respect to real property acquired by a trustee on the foreclosure of a mortgage. The only portion of the statute, which is claimed to violate constitutional limitations, is that which directs the trustee to treat as income and pay to the life beneficiary a limited portion of the net rents of each property acquired on the foreclosure of a mortgage, not to exceed in any year an amount equal to 3% of the principal of the foreclosed mortgage.

It is asserted that the statute attempts to change a rule theretofore established by the courts of New York, pursuant to which the rents, so required to be paid to the life beneficiary, would constitute capital of the trust to which the remaindermen will be entitled on the termination of the life estate; that, in effect, the statute takes the property of the remaindermen and gives it to the life beneficiary, and, therefore, the remaindermen are deprived of property without due process of law.

It has also been asserted that the legislature could not prescribe regulations for the administration of such fore-

closed properties, because this was within the exclusive jurisdiction of the courts.

Statement

Concerning the Proceeding

This proceeding was instituted, in the Surrogate's Court of the County of New York, by the respondent trustee, which applied for the judicial settlement of its account and for instructions concerning the distribution of rents and the proceeds of sale of real properties acquired by the trustee on the foreclosure of mortgages. In some instances, deeds in lieu of foreclosure were accepted, but as this is without significance on the question presented, in this brief we have treated all such properties as having been acquired on foreclosure.

The trustee's account conformed to the requirements of the statute and credited to income that portion of the rents from such properties which the statute directed should be paid to the life beneficiary. The account, with minor adjustments not here important, was allowed and settled and instructions were given to the trustee to effect distribution of the net rents as required by the statute. The Appellate Division of the Supreme Court and the Court of Appeals affirmed the Surrogate's decree in all respects. The remaindermen of the trust through their special guardian have now appealed from the judgment of affirmance of the Court of Appeals.

Concerning the Estate

Henry C. West died in 1934. He left no issue and his widow was the chief object of his bounty. By his will (R. 90) he gave her a legacy of $25,000 and the income from his residuary estate during her widowhood, less $100 per month during her life, which he bequeathed to his brother. After the termination of the trust for his widow, he gave the income from $30,000 to a nephew for life and the balance of his residuary estate to a niece or her issue and to issue of

his wife's niece. His desire to provide adequately for his widow is further emphasized by the direction that income was not to be diminished by setting up a sinking fund to amortize the premiums on securities, and that extraordinary dividends, other than stock dividends, should be deemed income; also by the authority granted to his trustee to retain investments made by him and to make new investments not limited to those classes, in which trustees are authorized by law to invest (R. 92).

At the time of his death his residuary estate amounted to approximately $147,000 if his bonds and mortgages are valued at par.*

The residuary estate consisted chiefly of bonds and mortgages owned by the testator. At the date of the account (July 31, 1940, R. 41), except for approximately $10,000 in bonds, the capital of the trust consisted wholly of bonds and mortgages and real properties acquired by the trustee on the foreclosure of other mortgages.

During the course of the administration of the estate, nine mortgages, securing in the aggregate $44,000 of principal, were foreclosed because of defaults in the payment of interest. In addition to the loss of interest on those bonds and mortgages, the income of the trust was further reduced by the income from $19,000 of capital which was used to pay the capital charges involved in connection with such foreclosures, including back taxes and the cost of rehabilitating the properties, operating expenses, etc. The following schedule shows this in greater detail:

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* This amount is arrived at by adding to the item of $133,104.64 (R. 40) the difference between the par and the appraised value of certain bonds and mortgages, to wit, $5,162.50; also, the sums expended by the executors before the properties were transferred to the trustees in connection with foreclosed mortgages, to wit, $8,785.39, the last two amounts being the aggregates computed from numerous items set forth in the account.

Premises	Principal of Mortgage	Principal Advances	Date From Which Int. Was Due	Reference Record, Pages
46 North St., Brooklyn	$ 4,000.	$ 3,494.98	11/1/33	47, 50
1855 E. 7th St., Brooklyn	7,000.	2,770.74	6/1/32	50, 53
2082 E. 9th St., Brooklyn	7,000.	4,242.66	4/1/34	53, 56
193 Bay 17th St., Brooklyn	5,000.	1,563.87	5/1/34	56, 59
1441-3 66th St., Brooklyn	4,500.	1,205.52	12/1/34	59, 62
2047 E. 27th St., Brooklyn	4,250.	2,028.54	11/1/32	62, 65
240 Floyd St., Brooklyn	3,000.	1,247.88	7/1/35	65, 68
168 Morrison Ave., New Brighton, Staten Island.....	4,500.	975.95	6/1/34	68, 69, 70
41 Montrose Ave., Brooklyn	4,750.	1,582.77	7/1/35	70, 72
	$44,000.	$19,112.91		

Of these nine properties only two had been sold prior to the date of the account. The parcel, 168 Morrison Avenue, was sold on August 25, 1939, for $4500 in cash (R. 19). The parcel, 41 Montrose Avenue, was sold on August 9, 1939, for $4000 of which $800 was paid in cash and the balance by a purchase money mortgage. The aggregate of the net rents from this property, plus the cash proceeds of sale, were not sufficient to pay off the principal advances made in connection with this parcel.

As a result of the foregoing, the widow was deprived for a substantial period of income from some $63,000 of capital, or 43% of the trust established for her benefit, except for such rents as might be payable to her and such deferred income as she may be entitled to receive on the sale of such properties and the collection of any purchase money mortgages which are accepted as partial payments for such properties.

Concerning the Rules of Administration Promulgated by the Courts With Respect to Such Properties.

When Henry C. West made his will in 1928 and when he died in 1934, he had no reason to fear that, if any of his mortgages were foreclosed, his widow could not use as income the rents from real property thereby acquired. At that time no decision had been rendered by any New York court suggesting that rent from real property would not be accorded its traditional character and treated as income, if such real property were acquired by a trustee upon the foreclosure of a mortgage. The only case, in which the matter of surplus rents was in any way involved, recognized that these should be credited to income (*Van Vleck* v. *Lounsbery*, 34 Hun 565; Gen. Term, N. Y. Sup. Ct., 1885). There the court rejected a claim that profits should be credited to income on the ground that interest on the mortgage and rents after foreclosure had been credited to income.

At an early date, the equitable rule was developed that, if property acquired by a trustee on the foreclosure of a mortgage was not productive of income during the period it was held by the trustee, then upon the sale thereof recognition should be given to the loss of income suffered by the life beneficiary and, therefore, that the proceeds of sale should be ratably apportioned between principal and income. However, there was conflict in the authorities as to the basis on which such apportionment should be made. In *Roosevelt* v. *Roosevelt*, 5 Redf. 264 (N. Y. Surr. Ct., 1881), the apportionment was made by finding the sum, which, with interest from the testator's death (the judgment of foreclosure having been rendered prior to his death) to the date of sale of the premises, would equal the net proceeds of sale. That amount was credited to capital and the balance to income. The interest was there computed at the equitable rate, that is the rate at which funds might have been prudently invested. In *Meldon* v. *Devlin*, 31 App. Div., 146, 158 (1898), affirmed 167 N. Y. 573, the court approved a judgment directing that the proceeds of sale

should be apportioned between the principal and income of the trust "in the ratio which the aggregate principal of the mortgage bears to the whole unpaid interest." No reference was made in either case to the disposition of rents. Apparently none was received by the trustees.

The rule with respect to apportionment was further amplified by a full and well-considered opinion in *Matter of Marshall*, 43 Misc. 238 (Westchester Co. Surr. Ct., 1904). In that case, also, no rents were produced as the property was unimproved. Substantial carrying charges were incurred which were paid out of the capital of the trust. The Surrogate stated that the amount of principal invested in the property upon which the apportionment should be based included, not only the principal of the mortgage, but all sums advanced out of capital in connection with the property, and that the income invested in the property should be deemed to be the interest "upon the principal locked up in the property, that is the original amount of the mortgage and the various amounts of principal paid out for taxes, assessments, etc., from time to time" (pp. 240-241). The Surrogate further held that, for the purpose of determining the amount of income invested in the property, interest should be computed not at the rate specified in the mortgage but at the equitable rate (p. 246).

When the values of New York real estate collapsed in 1932, following the earlier decline in the securities market, it became necessary for many trustees to foreclose mortgages and to take over the underlying properties. The question, as to the rules of administration to be pursued by trustees with respect to such properties, then assumed importance. The subject was twice considered by the New York Court of Appeals, first in the *Matter of Chapal*, 269 N. Y. 464 (1936), and shortly thereafter in the *Matter of Otis*, 276 N. Y. 101; 277 N. Y. 650 (1937). In the latter case, the court stated that the rules expressed should not be regarded as final for all cases.

The rules stated have since come to be known as the *Chapal-Otis* rules. We summarize them. A separate ac-

count should be kept with respect to each property bought in on the foreclosure of a mortgage. All expenses in connection therewith should be temporarily advanced out of the capital of the trust, including all expenses of the foreclosure, back taxes, and carrying charges in excess of rents after the property is acquired by the trustee. All sums so advanced by capital are to be regarded as a first lien or charge on the property. Upon the sale of the property, the proceeds should be distributed as follows: All capital advances, remaining unpaid, should be restored first. The balance, plus any net rents not theretofore applied to the repayment of capital advances, should be apportioned between principal and income in the ratio in which each is deemed to be invested in the property. The principal of the mortgage is the amount of principal deemed to be so invested; the interest in default, and which would have been earned had the mortgage not been foreclosed, should represent income. From the amount apportioned to income, the net rents, if any, paid to the life beneficiary, as income, are to be deducted. If, upon the sale of such property, the trustee accepts a purchase money mortgage in partial payment, then the cash, remaining after payment of capital advances, and the purchase money mortgage should each be apportioned between principal and income in the ratio in which the total proceeds of the salvage operation are to be apportioned.

In addition to the foregoing, for the first time, the court discussed the disposition of the rents received from a property so acquired by a trustee. The court apparently thought that the rule of apportionment rested on the theory the mortgage is security both for principal and interest and that, when a trustee forecloses such a mortgage, he is engaging in a salvage operation for both. It concluded that the whole salvage operation, from the foreclosure to the final liquidation, should be treated as a single transaction and that the amount to be apportioned between principal and income is the aggregate of all sums received during the salvage operation, *i. e.*, the net rents plus the net proceeds of sale.

In *Matter of Chapal*, the court merely noted the direction in the Surrogate's decree that, if there should occur a deficiency of income to pay carrying charges, subsequent surplus rents should first be used to restore to capital such earlier deficiencies, but that, with respect to other surplus rents, trustees should "exercise their own discretion and judgment with respect to distributing such surplus income entirely or of retaining the same or some part thereof to meet possible subsequent deficiencies" (470-471). Later, in *Matter of Otis*, there were expressions which led some to believe that the court would not approve of the distribution of any rents to the life beneficiary until all capital advances, including expenses of foreclosure, back taxes, rehabilitation costs, as well as earlier carrying charges, had been fully restored.

In the case now before this court, the Court of Appeals said that, under its earlier decisions, a trustee did have the right to exercise discretion with respect to the distribution of any surplus rents. However, in its earlier decisions, the court gave no indication as to whether a trustee would incur liability, if, in the exercise of that discretion, it should distribute surplus rents to a life beneficiary and subsequently, on the completion of the salvage operation, it was found that the rents so distributed were in excess of the life beneficiary's share of the aggregate of the surplus rents and proceeds of sale. One of the surrogates stated that a trustee would be liable to surcharge for any such overpayment to a life beneficiary. *Matter of Brainerd*, 169 Misc. 640, 645 (Kings Co. Surr. Ct., 1938). The possibility of a distribution of rents resulting in such an overpayment existed in every case. None could say how much would be realized on a sale, or whether this would be sufficient to repay the capital advances. In view of this, many trustees deemed it improper for them to effect a distribution of any rents until all capital advances had been restored. In effect, this resulted in a denial of any payment to the life beneficiary until the sale of the property, for the capital advances were in most instances so considerable

they could not be repaid out of rents for a long period of years.

The situation of the widow, in the case now before the court, well illustrates the plight in which life beneficiaries were placed. Forty-three per cent of the capital of her trust was tied up in such properties. Most were throwing off surplus rents, but, if it were the duty of the trustee to use these to repay all capital advances, no rent could be paid to the widow for many years. In all probability, nothing could be paid to her prior to the sale of the respective parcels.

This situation was not limited to a few isolated instances. It existed throughout the State. For many years, bonds and mortgages had been a preferred investment for trust funds.

Thus, a grave question of public importance was presented—should trustees continue to accumulate rents from real property for the benefit of future generations and contrary to the public policy of the state against accumulations of income, or should they be used presently for the benefit of the life beneficiaries of such trusts?

It was at this juncture that the Legislature acted.

The legislation enacted was recommended by the Executive Committee of the Surrogates' Association of the State of New York, which committee was composed of a number of distinguished surrogates. To the draft legislation presented by this committee was appended the Committee's note explaining its purpose. With respect to subdivision (2) of the proposed statute, that portion which is here involved, the committee stated (Pocket Supplement, 40 McKinney's Consolidated Laws of New York, Section 17-c of the Personal Property Law):

* * *

> (2) Further modifications are proposed by the second subdivision of the section as to mortgage investments already made in existing trusts. The present rules for apportionment between life tenant and remainderman under the Chapal-Otis cases are continued

as to existing trusts where the investment in a mortgage has been made, with modification thereof in two specific instances.

(a) The Chapal-Otis rule authorizes the trustee to pay surplus net income in his discretion. Trustees have hesitated to pay such net income because in the case of overpayment to the life tenant, the trustee might be surcharged with that amount. The life tenant of the trust must wait in the majority of cases for a long period of time before he becomes entitled to the payment of any income, because of the present requirement that advances from principal for the expenses of foreclosure and for arrears of taxes and other liens must first be paid from the net income of the property. The amendment provides for the immediate payment of income to the life tenant beginning with the date of the acquisition of the property by the trustee by foreclosure or conveyance in lieu of foreclosure. Under the new provisions net income up to three per centum of the face amount of the mortgage is so payable. Under the Chapal-Otis rules the life tenant is entitled in the final apportionment to the inclusion of interest at the mortgage rate during the period of the salvage operation. The rate of three per centum in the new section has been recommended as a fair return to the life tenant and at the same time a protection to the remainderman in the event that the property is sold at less than the face amounts of the income and principal shares employed as the ratio of the apportionment. (b) Surplus net income above three per centum is to be applied to the payment of advances from principal until the amount of such advances are satisfied. When the property in the salvage operation is sold, the unpaid balance of principal advances must be satisfied first out of the cash received from the sale. If there be any unpaid balance due for principal advances, it is made a primary lien upon the purchase money mortgage. The amendment further directs that after principal advances have been paid, the surplus net income above three per centum, accruing during the salvage operation, shall be held by the trustee to await sale and apportionment under the Chapal-Otis rules."

The statute so recommended was adopted by the legislature.

The Statute

The statute involved is subdivision (2) of Section 17-e of the Personal Property Law of New York, which was enacted by Chapter 452 of the Laws of 1940, in effect April 13, 1940. It is printed in full in the appellants' brief, pages 3 to 5.

Summary of Argument

1. The statute deprives neither the life beneficiaries nor remaindermen of any property.

(a) The property rights of a beneficiary in a trust consist solely of the right to enforce its execution. They have no title to any of the assets of the trust, the same being vested in the trustee.

(b) For the most part, the testator left to the rules of administration the ascertainment of the net income and principal of the trust, the distribution of which he directed. The beneficiaries will receive all to which they are respectively entitled upon payment to the income beneficiary of the net income determined by the application of such rules and the distribution to the remaindermen of the principal similarly so determined.

(c) The *Chapal-Otis* rules were mere rules of administrative procedure. They were tentative, not final. They are not founded on established equitable doctrines, but were formulated as practical guides, based on considerations of business policy. Those parts with which we are here concerned were not in existence, either at the time the testator made his will or when he died, nor did they constitute a restatement of previously expressed principles or rules. The testator could not therefore be deemed to have adopted and embodied them in his will, so that a change in such rules would

defeat the disposition of his property, which he intended to make by his will.

(d) The beneficiaries of a trust have no vested right in the maintenance of any rule of administrative procedure with respect thereto.

(e) The statute did not reduce the amount which might have been paid either to the remaindermen or life beneficiaries of trusts under the *Chapal-Otis* rules.

2. It is a recognized principle of New York law that the legislature may make and modify rules of administrative procedure affecting trusts. Since the legislature had power to enact the remedial statute in question, and it is in all respects reasonable, and deprived none of any property, it did not exceed any limitations imposed by the Fourteenth Amendment to the Constitution.

ARGUMENT

I

The statute deprives neither the life beneficiaries nor remaindermen of any property.

(a)

The beneficiaries of a trust have no title to or interest in any particular asset of the trust, but solely the right to enforce the execution of the trust (*Bennett* v. *Garlock*, 79 N. Y. 302, 320; *City of Mt. Vernon* v. *County Trust Co.*, 199 N. Y. Supp. 500, not officially reported).

In respect of a trust of personal property, title to all the trust assets is vested solely in the trustee (*Matter of Wilkin*, 183 N. Y. 104, 110). No title or interest vests in the beneficiaries (*Knox* v. *Jones*, 47 N. Y. 389, 396). This doctrine applies specifically to mortgages, and to real property bought in by a trustee upon foreclosure of a mortgage (*Lockman* v. *Reilly*, 95 N. Y. 64).

(b)

For the most part, the testator left to the rules of administration the ascertainment of the net income and principal of the trust, distribution of which he directed.

The beneficiaries will receive all to which they are respectively entitled, upon payment to the income beneficiary of the net income determined by the application of such rules, and the distribution to the remainderman of the principal similarly so determined.

The testator merely directed the trustee to pay and distribute the "net income" and the "principal" of the trust, not of any particular asset of the trust. He gave no direction with respect to his bonds and mortgages, nor with respect to the foreclosure of mortgages or the real property which might be acquired as a result thereof, nor with respect to the rents therefrom. He gave three specific directions bearing upon the determination of what should be deemed income or principal; (1) that no sinking fund should be set aside out of income to amortize the premiums on securities, (2) that stock dividends should be deemed principal, and (3) that all other extraordinary dividends should be treated as income. Aside from the foregoing, he gave the trustee no guide for the classification of receipts, nor whether particular expenses should be charged to principal or income. In the absence of further definition, the determination of net income and principal of the trust was subject to the application of rules of administration promulgated by the courts or by the legislature. As we shall show hereafter, both have heretofore participated in the formulation of rules of administration with respect to trusts.

(c)

The *Chapal-Otis* rules were mere rules of administrative procedure. They were tentative, not final. They were not founded on established equitable doctrines, but were formulated as practical guides based on considerations of business policy. Those parts with which we are here con-

cerned were not in existence, either at the time the testator made his will or when he died, nor did they constitute a restatement of previously expressed principles or rules. The testator could not, therefore, be deemed to have adopted and embodied them in his will, so that a change in such rules would defeat the disposition of his property which he intended to make by his will.

It would seem that some rules of administrative procedure may become so certain and definite and be accepted for such a length of time, that a testator or settlor may be deemed to have acted in reliance thereon in drawing his will or trust instrument and be said inferentially to have embodied them in his will or trust instrument, *American Security & Trust Co. v. Frost*, 117 Fed. (2d) 283, 285 (1940).

The *Chapal-Otis* rules had none of these characteristics. At the time the testator executed his will, and at the time of his death, these *Chapal-Otis* rules had not even been enunciated. The only rules bearing upon this subject which had acquired any degree of certainty were (a) that expenses of foreclosure should be charged to capital, and (b) that, if real property so acquired was unproductive of income while held by a trustee, the proceeds of sale should be apportioned between principal and income; but the basis for that apportionment enunciated in the *Chapal-Otis* rules had not been established. In fact, the basis there stated was different from that which had been stated previously by the lower courts. *Roosevelt v. Roosevelt*, *supra*, and *Matter of Marshall*, *supra*. With respect to the rents from such a property, there was no suggestion that they should be treated differently than the rents from any other property. In the only case where such rents were considered, it had been recognized that they had been properly treated as income. *Van Vleck v. Lounsbery*, *supra*.

That these *Chapal-Otis* rules were mere rules of administration and that the Court of Appeals understood them to be such, is shown, not only by the statement of the court in *Matter of Otis* (p. 115), but also in the court's refusal to follow established equitable doctrine in their formu-

lation. Apparently, it believed that the application of accepted equitable principles would prove impractical to deal with the countless properties which had been acquired by trustees on the foreclosure of mortgages, and therefore, promulgated rules "shaped by considerations of business policy" "in the endeavor to express fair, convenient, practical guides that [would] be largely automatic in their application," and expressly declared that they should not be regarded as "final for all cases" (276 N. Y. 115).

When a trustee buys in the underlying property on foreclosing a mortgage, he holds the land upon a trust "implied" or "created by law" to sell the property and reconvert it into personalty. *Lockman* v. *Reilly*, 95 N. Y. 64.

There were, therefore, available to the court in the solution of the various questions arising in connection with such foreclosed property, all the equitable principles theretofore established with respect to the express trusts to sell real property, invest the proceeds and distribute the income and principal. The rules which had been evolved in connection with these trusts were well defined. Expenses in excess of rents were payable from capital. *Furniss* v. *Cruikshank*, 230 N. Y. 495, 510 (1921). If the rents collected did not represent an adequate income, then the proceeds of sale, plus any rents received, were distributable between income and principal. In the determination of the proportionate share of income, interest was to be computed at the equitable rates, *i. e.*, that prevailing for trustee's investments during the period that property was held after the duty to sell arose. *Lawrence* v. *Littlefield*, 215 N. Y. 561, 583 (1915). *Furniss* v. *Cruikshank*, *supra*, 509; *Restatement of the Law of Trusts*, Sec. 241.

Any rents distributed as income would of course be deductible from income's share. *Restatement of the Law of Trusts*, Sec. 241, Comment d.

Principal's share was that amount which with interest at such rate would equal the net proceeds of sale. *Lawrence* v. *Littlefield*, *supra*, *Furniss* v. *Cruikshank*, *supra*, *Matter of Jackson*, 258 N. Y. 281 (1932).

The lower courts of New York had applied these principals to foreclosed properties, *Roosevelt* v. *Roosevelt*, 5 Redf. 264 (N. Y. Co. Surr. Ct., 1881), and *Matter of Marshall*, 43 Misc. 238 (Kings Co. Surr. Ct., 1904).

The courts of other jurisdictions also applied these same principles. *Nirdlinger's Estate* (No. 2), 327 Pa. 171, 193 Atl. 30 (1937); *Springfield Safe Deposit & Trust Co.* v. *Wade*, 305 Mass. 36, 24 N. E. (2d) 764 (1940); *Quinn* v. *First National Bank*, 168 Tenn. 30, 73 S. W. (2d) 692 (1934); *Restatement of the Law of Trusts*, Sec. 241. In *Nirdlinger's Estate* (No. 2), *supra*, the Supreme Court of Pennsylvania also held that, if payments had been made from capital in connection with such a property, interest at the equitable rate should be computed not only on the principal amount of the mortgage, but also on all advances from capital. This was the rule enunciated by the surrogate in *Matter of Marshall, supra.*

It appears that the court rejected these familiar principles because it thought they would lead to complexity and uncertainty, and that a more practical guide should be involved, which would permit a trustee to deal with such problems without the aid of judicial instructions. In rejecting the calculation of interest at the equitable rate, and disallowing interest in all capital advances, it said, *Matter of Otis*, 276 N. Y. 101, 113, "Interest on each item would have to be computed at the currently prevailing rate for legal investments [those in which trustees are authorized to invest]—a fluctuating factor not readily ascertainable. The parties can hardly be thought to have contemplated such actuarial calculations."

In case of express trusts for the sale of property, it seems always to have been assumed that any net rents collected would be payable to the life beneficiary, and, therefore, there is little discussion of this subject either in the authorities or in the "Restatement of the Law of Trusts". Section 241 (d) of the latter gives implicit recognition that net rents should be paid to the life beneficiary, for it states that any interim payments to the life tenant shall be deducted from his share in the final apportionment.

The reason for this lack of discussion in the case of express trusts is not difficult to find. In New York, accumulations of income are not permitted except for a minor. No ingenious device to effect an accumulation indirectly, as by paying capital charges out of income, are permitted. *Hascall v. King*, 162 N. Y. 134. Therefore, a testator or settlor could not validly direct that until his real property be sold, all net rents therefrom should be accumulated to await distribution at that time. Under these circumstances, and in the absence of an express direction, it would be unreasonable to construe a trust instrument as impliedly directing that, if real property were bought in upon the foreclosure of a mortgage, any rents therefrom should be so accumulated. In fact, it would seem that an express direction to this effect would be held invalid for there is no reasonable distinction between an express and implied trust for the sale of real property.

It seems obvious that the *Chapal-Otis* rules were not intended to be and should not be accorded the dignity of rules of property. They were "practical guides" shaped by "considerations of business policy", and not based on accepted equitable principles, and they were enumerated by the court as tentative rules, with the express statement that they were not to be considered "final for all cases". As was well said in *United States* v. *Standard Oil Company of California*, 20 F. Supp. 427, 458, aff'd 107 F. (2d) 402, cert. denied 309 U. S. 673:

> "However, before setting up a judicial declaration as a rule of property, we should require, at least, that it be fixed, long-continued, and relied upon by persons acquiring property, so that its repudiation would amount to a denial of due process."

Certainly, rules not formulated until 1936 and 1937 cannot be considered rules of property affecting a will drawn in 1928 by a testator who died in 1934.

The argument that the statute is unconstitutional rests on the proposition that it transfers the property of the remaindermen to the life beneficiary. To determine the rights of the life beneficiary and remaindermen, we turn to

the will, the source of their title. Here we find merely a bequest of the net income of the trust to one and of principal to others.

Even if we assume *arguendo*, that under the *Chapal-Otis* rules, no part of the rents would have been payable to the widow until all capital advances had been repaid, we must remember that these rules were not in existence when the will took effect. Since the will indicates that the testator's widow was the primary object of his bounty, we may appropriately conclude that, if the application of the *Chapal-Otis* rules would have the effect of depriving her of the income from a large part of the principal of the trust for an extended period, and that the statute changed these rules so as to restore to the widow some of that income, the statute tends to give effect to the testator's intent rather than to defeat it. It follows, therefore, that any argument that the statute transferred to the widow property given by the testator to the remaindermen is wholly fictitious.

(d)

The beneficiaries of a trust have no vested right in the maintenance of any rules of administrative procedure with respect thereto.

None has a vested right in the maintenance of any rules of procedure. There is no constitutional limitation against a change of such rules even if such change is applicable to existing contracts or property. The mere fact that a change in such rules may result in decreasing the amount one would otherwise receive, or in increasing the amount one would otherwise be required to pay, is no impediment to such change being effected by legislation. *Preston Co.* v. *Funkhouser*, 261 N. Y. 140, affirmed 290 U. S. 163 (1933); *People ex rel. Eitel* v. *Lindheimer*, 371 Ill. 367, 21 N. E. (2) 318, 308 U. S. 505 (1939); *Carpenter* v. *Wabash Ry. Co.*, 309 U. S. 23 (1940).

As we shall show hereafter, rules with respect to the administration of trusts are regarded as rules of administrative procedure possessing the same characteristics as

other rules of procedure, in that they are subject to legislative change.

(e)

The statute did not reduce the amount which might have been paid either to the remaindermen or life beneficiaries of trusts under the *Chapal-Otis* rules.

The argument of unconstitutionality proceeds on the assumption that, under the statute, the remaindermen will or may receive less than they would be entitled to under the *Chapal-Otis* rules. It is based upon the appellant's contention concerning the proper interpretation of those rules. Such argument was doubtless one which was appropriately addressed to the court below, but hardly here, for we assume that this court will accept the Court of Appeals' interpretation of the meaning and effect of the rules which that court promulgated.

It was urged in the Court of Appeals, as it is argued here, that under a proper interpretation of the *Chapal-Otis* rules, no surplus rents could be paid to a life beneficiary until all capital advances had been repaid, and that if enough were not realized upon the sale of the property to repay such capital advances, all surplus rents as might be necessary must be used for such purpose.

However, the majority of the court held that, under the *Chapal-Otis* rules, a trustee had discretion to distribute surplus rents, and that if in exercise thereof he paid such rents to a life beneficiary, he would not have been liable to surcharge therefor. The court said, referring to its opinion in the *Otis* case (R. 120):

> "It was also carefully pointed out that no hard and fast rule was laid down to guide the trustee in the disposition of net income earned during the salvage operation, but the disbursement of net income to the life beneficiary was left to the discretion of the trustee."

It also said (R. 121):

"In thus formulating a rule that is final against recoupment for distribution of income received in excess of carrying charges, it does not appear that the Legislature has done more than direct a trustee to do what under the decisions of this court he has discretionary power to do. (*Matter of Otis, supra.*) Before the enactment of this statute, the life tenant could not have demanded as of right the payment to him during liquidation of more of the surplus income than he will receive under the statute. Neither does it appear that the remaindermen could properly have insisted that the trustee should be surcharged if in the exercise of his discretion he had paid to the life tenant the amount which the statute now directs. A statutory rule of administration which requires the trustee to apportion income in accordance with a fixed standard which in the exercise of administrative discretion the trustee would even without the statute have power to adopt does not, in our opinion, constitute a taking of property."

II

The New York State Legislature had power to enact the remedial statute in question. It is in all respects reasonable and does not violate the Fourteenth Amendment to the Constitution.

(a)

Under the law of New York, the legislature may make and modify rules of administrative procedure affecting trusts.

In New York, both the courts and the legislature have taken part in the formulation of rules for the administration of trust estates. They are not rules of law resting upon matters of public policy. They are merely rules for the guidance of trustees with respect to matters upon which

the testator or settlor has given no express direction. A testator or settlor may, therefore, direct, that a different rule than that which has been formulated by the courts or the legislature shall be followed by his trustee (*Crabb v. Young*, 92 N. Y. 56, 65; *Matter of Reid*, 170 App. Div. 631, 634, aff'd. 218 N. Y. 640).

Courts of equity established rules with respect to the investments which might properly be made by a trustee (*King* v. *Talbot*, 40 N. Y. 76, 83 (1869)). These rules have been repeatedly modified by statute, and these modifications have been held to apply to existing trusts (*City Bank Farmers Trust Company* v. *Evans*, 255 App. Div. 135, 1938; *Matter of Hammersley*, 152 Misc. 903, 1934). Obviously the character of the investments will, to a large extent, determine the amount of income of the life beneficiary and the amount of principal which may remain for distribution upon the termination of the trust.

Under the former chancery rules prevailing in New York, neither executors nor trustees were entitled to any compensation for their services, but when an act was passed in 1817 authorizing the courts to make an allowance to executors, administrators, and guardians, upon the settlement of their accounts, for services in the discharge of their trusts, it was held that the statute was retrospective in its operation and was intended to embrace cases where the services had been performed before the passage of the statute, if the settlement of the account took place afterwards (*Dakin* v. *Demming*, 6 Paige Ch. 95, 1836).

It has since been definitely established by the New York courts that the legislature may modify the rules with respect to the allowance of commissions to trustees with respect to trusts theretofore established (*Matter of Barker*, 230 N. Y. 364, 1921; *Robertson* v. *DeBrulatour*, 188 N. Y. 301, 316, 317, 1907). Although commissions of trustees were substantially doubled by a statute enacted in 1916, it was held in *Matter of Barker, supra*, that the new rates of commissions were applicable to existing trusts.

In 1914, what is now Section 225 of the Surrogate's Court Act was enacted, providing, "Where power to mort-

gage, lease or sell real estate is given by a will to an executor or trustee, an administrator with the will annexed or a successor trustee may execute such power in any case where the original executor or trustee could execute the same, unless contrary to the express provisions of the will."

In *Hollenbach* v. *Born*, 238 N. Y. 34, 1924, the application of this section to an administrator with the will annexed, who was appointed after that section took effect, under a will which had been probated long prior thereto, was challenged. Although recognizing that before the passage of this act an administrator with the will annexed could not have exercised a discretionary power of sale, the court upheld the application of the statute on the ground that the statute did not change "existing substantive rights".

Similarly, Sections 67-71 and Sections 105-107 of the New York Real Property Law, authorizing the Supreme Court to direct a sale or to empower a trustee to mortgage or sell real property, have been held to apply to existing estates (*Matter of Mersereau*, 233 N. Y. 540, 1922), and this notwithstanding a testamentary direction that the real property should not be sold (*Matter of O'Donnell*, 221 N. Y. 197, 1917).

The legislature has on many other occasions enacted statutes modifying other rules of administration which have been established by the courts, but we omit reference thereto as the validity of these statutes seems to have been recognized without litigation.

Thus it appears to be the established law of New York that if substantive rights are not disturbed, the legislature is free to change the rules of administration with respect to trusts; further that in some respects the powers of the legislature with respect to trusts are more extensive than are those of the courts.

In *Clarke* vs. *Van Surlay*, 15 Wend. 436, aff'd 20 Wend. 365 (1836), the court upheld a private statute appointing a new trustee and authorizing the trustee so appointed to sell the real property constituting the trust. The court, referring to Blackstone's Commentaries, held that such power

had existed in Parliament and that it existed in the legislature of the state of New York. With respect to the appointment of a trustee, the court said (p. 442):

> "There can be little doubt that the court of chancery, without an act of the legislature, could have discharged the trustees selected by the testatrix, and appointed others in their place; and although the expediency of changing the trustees by law, instead of leaving it to the chancellor, may be questioned, it was not an act beyond the power of the legislature. The mere substitution of a new trustee could neither defeat the trust nor divest the rights of those beneficially interested in the property."

As above stated, in New York these rules affecting the administration of trusts have been treated as rules of procedure. In *Matter of Barker, supra*, 230 N. Y. 364, where the court held that a statute increasing the compensation of trustees was applicable to an existing trust and to the allowance of commissions for services theretofore rendered, the court said (p. 372):

> "The general rule is that the fees of an executor are to be fixed by the rules and law which prevail at the time when they are settled. (*Robertson* v. *de Brulatour*, 188 N. Y. 301, 316, 317; *Whitehead* v. *Draper*, 132 App. Div. 799.) In the last case this principle was applied in the opinion written by Justice McLaughlin in a case where the statute invoked in aid of an executor's commissions was not passed until after his death. This is quite akin to the rule that remedies will be applied in accordance with the law which prevails at the time when relief is sought rather than at the time when the injury arose."

In *Matter of Potter*, 106 Misc. 113 (1919), where the same statute was considered, the court said:

> "Acts relating to procedure are therefore not retroactive in the sense that they relate back to and modify a pre-existing state of right. Rather are they prospective since they apply only to a ruling to be made in the future, albeit with respect to transactions in the past which come up for adjudication in the future."

Doubtless this treatment of rules of administration arises from the fact that the administration of trusts is always subject to the supervision of the chancellor or the courts which have been authorized to exercise the chancellor's powers, and all questions, as to whether a trustee has followed the correct rules of administration, are tested in an action or proceeding where these rules are applied. Those cases dealing with the award of compensation involve this principle. Commissions are awarded in a proceeding for the settlement of the trustee's accounts.

(b)

This court will not disturb the determination of the New York Court of Appeals concerning the power of the State legislature to enact the statute in question. It will confine its inquiry to the question whether, in exercising that power, the legislature violated any provision of the Federal Constitution.

The question discussed by LEWIS, *J.* (R. 126-7), in his dissenting opinion in the Court of Appeals, concerning the power of the legislature to modify rules of administration with respect to existing trusts, was doubtless a proper subject for consideration by the State courts. So also was the question as to whether the statute violated the State Constitution, it having been contended by the appellants that the statute violated the provisions of both the Federal and State Constitutions (R. 79). This court, however, will not disturb the determination of the court below that, under the state law, the legislature had power to enact the statute, and that it did not violate the State Constitution (*Terrace* vs. *Thompson*, 263 U. S. 197, 224; *Giozza* vs. *Tiernan*, 148 U. S. 657, 661).

(c)

Because of the uncertainty in the correct rules of administrative procedure and the consequent hardship on income beneficiaries, it was most appropriate for the legislature to enact the statute in question.

The object of the statute was to provide a definite rule under which trustees might distribute to life beneficiaries rents collected upon properties which had been acquired upon foreclosure. Before the enactment of the statute such rules as had been established were so indefinite and uncertain that life tenants were deprived of any income during indefinitely extended mortgage salvage operations.

The state of the New York law before the *Chapal* and *Otis* decisions in the Court of Appeals is graphically stated by the Surrogate in *Matter of Pelcyger*, 157 Misc. 913, 915 (1936), as follows:

> "Unfortunately, as will hereinafter appear, the rules of conduct in such situations, heretofore formulated by the courts, are in somewhat serious conflict, with the result that the legion of affected interests has been compelled to flounder in semi-darkness with no adequate judicial guidance to illuminate the path which they should pursue."

In *Matter of Chapal* the court left undetermined various questions including the question as to the distribution of income. In *Matter of Otis* it was stated that a trustee had some undefined discretion to distribute income received during the salvage. As the Executive Committee of the Surrogates' Association informed the legislature: "Trustees have hesitated to pay such net income because in the case of overpayment to the life tenant, the trustee might be surcharged with that amount."

It was to overcome this uncertainty in the law that the legislature acted. It sought to simplify "the rules of procedure in mortgage salvage operations and the elimination of present complications which work to the disadvantage of the life tenant * * *." (Sub-paragraph (d) of subdivision 2 of the statute.)

There can be no doubt but that the uncertain and unsatisfactory state of the law presented an appropriate subject for legislative action. This is well illustrated by *Funkhouser* v. *Preston Co.*, 290 U. S. 164. There considered was the New York statute providing for the recovery of interest upon principal sums awarded in actions for breach of con-

tract without regard to whether the principal sum was liquidated or unliquidated. The constitutionality of the application of the statute to a pre-existing obligation was questioned. Because the New York law before the enactment of the statute was "not clear and certain" (290 U. S. at 166), this Court said that—

> "Without attempting to review the numerous, and not harmonious, decisions upon the allowance of interest in the case of unliquidated claims, it is sufficient to say that the subject is an appropriate one for legislative action in order to provide a definite rule." (168)

Kuehner v. *Irving Trust Company*, 299 U. S. 445, involved the constitutionality under the Fifth Amendment of Subdivision (b) (10) of Section 77B of the Bankruptcy Act limiting landlords' claims in proceedings under that section to an amount not to exceed three years' rent. This Court in upholding the statute said (p. 453);

> "It gave a new and more certain remedy for a limited amount, in lieu of an old remedy inefficient and uncertain in its result."

Clearly the New York Legislature in enacting Subdivision 2 of Section 17-c was acting within the scope of its legislative authority. As heretofore set forth, the statute took away no vested right and deprived none of any property. In the enactment of the statute the legislature merely performed its proper function to remedy a defect in the common law (*Munn* v. *Illinois*, 94 U. S. 113, 134) and to supply a definite rule for one that was indefinite and uncertain (*Funkhouser* v. *Preston Co.*, *supra*). Since the statute has "a reasonable relation to a proper legislative purpose", it is not to be condemned, unless it is arbitrary or discriminatory (*Nebbia* v. *N. Y.*, 291 U. S. 502, 537; *Kuehner* v. *Irving Trust Co.*, *supra*, 455).

(d)

The statute is not arbitrary or capricious, but on the contrary is fair and reasonable and was designed to protect

both the interests of the life beneficiaries and remaindermen. Its validity should, therefore, be sustained.

The statute expressly preserves the rule of apportionment previously established by the courts. No effort was made to change the amount that ultimately would be paid either to the life beneficiary or remainderman. It merely provides for a regular and orderly distribution of part of the income from a foreclosed property pending a resale by the trustee. It displaces uncertainty with certainty. Instead of requiring the trustee to exercise discretion, without any guiding chart, as to whether he should or should not distribute income to a life beneficiary, it supplies a definite rule. True, it does not require that all the net income first received shall be used to repay capital charges, but it protects those interested in the capital of the trust by specifically providing that any capital charges not repaid out of the income "shall be a primary lien upon the proceeds of sale and shall be paid first out of any cash so derived. If insufficient the balance shall be a primary lien upon any purchase money mortgage received upon the sale." [Subparagraph (c).]

The statute shows meticulous care to preserve a nice balance in establishing a rule which would be fair not only to the life beneficiary but to remaindermen. Under the statute, a life beneficiary can receive nothing pending a resale of the property unless it produces net income. If it does produce net income in any year, the trustee is not permitted to pay all of that to the life beneficiary, but only three per cent of the principal of the mortgage. All surplus income above such three per cent must be impounded to await a resale of the property.

In determining the reasonableness of the statute, the court may appropriately take cognizance of the fact that the rules established with respect to such salvage operations in other states, without the aid of any statute, are doubtless more favorable to life beneficiaries than are rules established by the statute here in question. We have already alluded to the authorities of other states (*supra*, page 17). In addition to what is there stated, it may also be noted that

the Supreme Court of Pennsylvania determined that if the proceeds of sale consist in part of a purchase money mortgage, any cash received on the sale must be used to pay the deferred income to which the life beneficiary is entitled (Re *Nirdlinger's Estate*, 327 Pa. 171, 193 Atl. 30, 35).

The appellant refers to the statement found in subdivision (d) of the statute, that the life tenant "is usually the principal object of the testator's or settlor's bounty", and asserts that the legislature has interpreted the intent of each and every testator who died prior to the enactment of the statute, and whose estate contained a salvage operation. Obviously, the legislature did not find that the life beneficiary is always the chief object of the testator's bounty, but merely that this is usually so. That was the opinion of the Executive Committee of the Surrogate's Association as expressed in its report to the legislature, and surely there is none better able to form an opinion upon that subject than the surrogates. As we have seen, it was true in the instant case. At least, it is clear that the Legislature was not unreasonable in determining that creators of trusts, having directed the payment of income to life beneficiaries, meant that their direction to pay income should be followed.

In establishing a general rule, the legislature was required to consider the usual, and not the exception. As stated by the court in *Home Bldg. & L. Association* v. *Blaisdell*, 290 U. S. 398, 446, "It does not matter that there are, or may be, individual cases of another aspect. The legislature was entitled to deal with the general or typical situation."

The appellant particularly stresses the provisions of the statute to the effect that if, upon the final liquidation, it appears that the amount of surplus rent paid to the life beneficiary is in excess of the life beneficiary's share of the total amount realized in the salvage operation, *i. e.* the surplus rents plus the proceeds of sale, there is to be no recoupment from the life tenant.

This is in no way improper or unusual. The legislature might have gone further than to provide merely that the surplus rents in any year up to three per cent of the prin-

cipal of the mortgage should be deemed income. It might have provided that all surplus rents should be deemed income and be distributed as such. Traditionally, rent has always been regarded as income, and traditionally, income cannot be recaptured merely because the principal investment may be lost due to depreciation in value.

In *Dgett* vs. *Title Guarantee & Trust Company*, now pending before this court (No. 227, October term, 1943), it is asserted that if the provisions of Section 17-c are applied, the final liquidation will not produce a sum sufficient to pay all capital advances. That result is not to be attributed to the fact that rent was received and paid to the life beneficiary, but rather to the depreciation in the value of the property after the inception of the salvage operation, or to improvidence on the part of the trustee in attempting to salvage an investment when there was no equity to salvage.

As heretofore indicated, the statute may not be condemned, because in some instances a slightly different result may occur from its application than that which would have occurred had the statute not been enacted.

Conclusion

The validity of the statute should be sustained. It was within the power of the legislature of New York to enact it. The statute is in all respects reasonable and appropriate to accomplish its purpose to remedy the defects in the rules of administration which had been tentatively promulgated by the courts. It deprives none of any property without due process of law.

Respectfully submitted,

C. Alexander Capron,
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J. Karr Taylor,
J. Dinsmore Adams,
Of Counsel.

SUPREME COURT OF THE UNITED STATES.

Nos. 52 and 227.—October Term, 1943.

William J. Demorest, Jr., Ann Demorest and Carolyn Demorest by Francis J. Mahoney, their Special Guardian, Appellants,	
52 *vs*	
City Bank Farmers Trust Company, as Trustee under the Will of Henry C. West, Deceased, et al.	On Appeals from the Surrogate's Court of New York County, State of New York.
Thomas B. Dyett, Special Guardian for Joachim Heinrich Schmidt, Appellant,	
227 *vs.*	
Title Guarantee and Trust Company, et al.	

[January 17, 1944.]

Mr. Justice Jackson delivered the opinion of the Court.

Appellants in these two cases challenge the constitutionality of Subdivision 2 of § 17-c of the Personal Property Law of the State of New York, approved April 13, 1940.[1] Because of retroactivity it is said to offend the Due Process Clause of the Fourteenth Amendment to the Federal Constitution by taking for benefit of income beneficiaries property to which the appellants as bene-

[1] N. Y. Laws 1940, c. 452, p. 1182. The subsection provides:

"2. The existing rules of procedure applying to salvage operations respecting existing mortgage investments are continued except as modified by the subparagraphs hereinafter set forth. The terms and rules of procedure of this subdivision shall apply specifically (a) to the estates of persons dying before its enactment and (b) to mortgages on real property held by a trustee under a deed of trust or other instrument executed before the date of its enactment and (c) to real property acquired by foreclosure of mortgage or real property acquired in lieu of foreclosure before or after the date of its enactment in trusts created or mortgage investments made prior thereto, and (d) to any pending proceeding or action for an accounting of the transactions of an executor or trustee.

"(a) Net income during the salvage operation up to three per centum per annum upon the principal amount of the mortgage shall be paid to the life tenant, regardless of principal advances for the expenses of foreclosure or of

ficiaries of principal claim vested rights. It is asserted, also, to deny equal protection of the laws.

The facts in No. 52 are these: Henry West died in 1934. His will, so far as concerns us, left a residuary estate in trust. Net income less certain payments to a brother was given to his wife during her life or widowhood. Thereafter, subject to certain further trusts, the residue was to go to contingent remaindermen, among whom are the appellants.

At death West owned a number of mortgages. Owing to defaults, titles to nine of the underlying properties were acquired either by foreclosure sale or by deed in lieu thereof, and held in separate accounts as assets of the trust. The trustee's accounting disclosed that two such salvage operations were completed by sale of the properties prior to the enactment of § 17-c of the Personal Property Law. No distribution had been made of the proceeds. Objections on behalf of remaindermen questioned the validity of the statute as applied to apportioning such proceeds between income and principal. Surrogate Foley, however, upheld the

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conveyance in lieu of foreclosure and arrears of taxes and other liens which occurred prior to such foreclosure or conveyance and the cost of all capital improvements. Any payment of net income heretofore or hereafter made to the life tenant up to such three per centum per annum shall be final and shall be not subject to recoupment from the life tenant or as a surcharge against the trustee or executor. The amount of all such payments shall be taken into account, however, in the apportionment of the proceeds of sale and shall be charged against the share of the life tenant.

"(b) The foregoing principal advances shall be repaid out of excess net income above such three per centum per annum. When principal advances have been satisfied, any excess income shall be impounded (subject to reinvestment under the terms of the will or deed) to await sale and apportionment.

"(c) The unpaid principal advances shall be a primary lien upon the proceeds of sale and shall be paid first out of any cash so derived. If insufficient the balance shall be a primary lien upon any purchase money mortgage received upon the sale.

"(d) The purpose of the enactment of this subdivision is declared to be the simplification of the rules of procedure in mortgage salvage operations and the elimination of present complications which work to the disadvantage of the life tenant, who is usually the principal object of the testator's or settlor's bounty, by depriving him of a fixed right to the actual payment of any net income earned by the property. Such fixed right is granted in lieu of the discretion now given to the trustee to pay net income or any part thereof to the life tenant. The general rules of the apportionment of the proceeds of sale between life tenant and remainderman are retained subject to the express modifications made herein. Only equitable adjustments and balances as between the parties are intended to be effectuated by the provisions of this subdivision. If any provision of this subdivision or the application thereof to any mortgage or acquired property by foreclosure or conveyance, or to any trust is held invalid, the remainder of the subdivision and the application of such provision to any other mortgage or property acquired by foreclosure or conveyance or other trust shall not be affected thereby."

statute and resolved the apportionment under its terms. His decree was unanimously affirmed by the Appellate Division of the Supreme Court for the First Judicial Department and thereafter was affirmed by the Court of Appeals, two judges dissenting. *Matter of West*, 289 N. Y. 423. The case is brought here by appeal.

In No. 227, Auguste Schnitzler died in 1930, leaving a will which put her residuary estate in trust with the income payable to a sister for life. The income beneficiary died in 1939. Salvage operations had begun in the lifetime of the beneficiary and were completed after her death. Surrogate Delehanty found that operation of the statute "resulted over the whole salvage period in taking for income account more than the whole of what the property earned in that period. The deficit in so-called 'income' was made up by taking principal, of course." He considered the result "startling" but settled the accounts under the statute, leaving its validity to be determined by appellate courts. The Court of Appeals affirmed without opinion on the authority of *Matter of West*, and the case comes here by appeal.

The grievance of remaindermen in these cases is not that they have suffered loss or deprivation of any specific property to which they had legal title. Under the law of New York the whole legal estate vests in the trustee for purposes of the trust,[2] including title to mortgages and to real estate acquired upon or in lieu of their foreclosure, which becomes personalty for the purposes of the trust.[3] Where the instrument creating the trust directs payment of income to one set of beneficiaries and corpus to another, allocation of receipts and disbursements as between capital and income is sometimes attended with difficulty. Mortgage investments may be imperiled by default in interest only, or payments of principal alone, or of both, but in either event both income and capital interests require protection. Advancements often must be made to remove tax liens or other prior charges, pay costs of foreclosure, make property tenantable, or take care of operating losses, watchmen, or insurance. On final sale the price, together with rentals, may leave either a loss or a profit, and to forego income for a period may result in a better sale of the capital asset. The variety of circumstances under which trustees are called upon

[2] Knox *v.* Jones, 47 N. Y. 389; Bennett *v.* Garlock, 79 N. Y. 302. *Cf.* 1 Scott on Trusts, p. 3.

[3] Lockman *v.* Reilly, 95 N. Y. 64.

to allocate items between capital and income are innumerable in salvage operations, the will rarely provides guidance, and the wisest and most faithful trustee is unable to draw the line with any great assurance. Either the income beneficiary or the remaindermen may challenge his accounts, for they have equitable interests which chancery will enforce that the trust be administered diligently and faithfully according to the will and the law. The flood of issues as to allotment of receipts and disbursements to capital or income account, following the depression, led the Court of Appeals to attempt to clarify the chancery rules on the subject for better guidance of trustees and the courts that supervise them.[4] When this was only partially successful, the problem of clarification was carried further by legislation. The remaindermen claim an unconstitutional taking of their property results from this legislative enactment of rules for distribution as between income and capital beneficiaries of trust property involved in salvage operations, because they are less favorable to the remainder interests in these cases than the rules they claim otherwise would have applied.

Appellants' contention is that the New York Court of Appeals established a rule of apportionment of proceeds of salvage operations of mortgaged property as between income and principal which became a settled rule of property under which property rights vested in them prior to accounting by the trustees. This they say, was accomplished by the decisions in *Matter of Chapal*, 269 N. Y. 464 (1936), and *Matter of Otis*, 276 N. Y. 101 (1937). The Court of Appeals, however, in one of the present cases holds to the contrary, saying that these opinions represent tentative judicial efforts to guide the discretion of trustees; that they did not establish rules of property; and that the legislature appears to have done no more than to direct trustees to do what they already had discretion to do, in which case remaindermen could not have insisted upon their being surcharged under the law before the enactment.

In thus rejecting appellants' version of its previous decisions the Court of Appeals disposed of their cases on the ground that appellants have never possessed under New York law such a prop-

[4] In New York, power to "direct and control the conduct, and settle the accounts" of trustees is allotted to the Surrogate's Court. Surrogate's Court Act § 40(3).

erty right as they claim has been taken from them. If this is the case, appellants have no question for us under the Due Process Clause. Decisions of this Court as to its province in such circumstances were summarized in *Broad River Power Co.* v. *South Carolina*, 281 U. S. 537, 540, as follows: "Whether the state court has denied to rights asserted under local law the protection which the Constitution guarantees is a question upon which the petitioners are entitled to invoke the judgment of this Court. Even though the constitutional protection invoked be denied on non-federal grounds, it is the province of this Court to inquire whether the decision of the state court rests upon a fair or substantial basis. If unsubstantial, constitutional obligations may not be thus evaded. But if there is no evasion of the constitutional issue, and the non-federal ground of decision has fair support; this Court will not inquire whether the rule applied by the state court is right or wrong, or substitute its own view of what should be deemed the better rule, for that of the state court."[5]

Despite difference of opinion within the Court of Appeals as to the effect of its earlier cases, we think that the decision of the majority that they did not amount to a rule of property does rest on a fair and substantial basis. The opinion in the *Otis* case had indicated a tentative quality in its pronouncements, saying: "Perhaps it should be added that a general rule for such situations cannot be attained at a bound, that no rule can be final for all cases and that any rule must in the end be shaped by considerations of business policy. Accordingly, we have here put aside inadequate legal analogies in the endeavor to express fair, convenient, practical guides that will be largely automatic in their application. Only the sure result of time will tell how far we have succeeded." And the opinion had pointed out that the disbursement of net income during salvage operations was left to the discretion of the trustee with the admonition that the discretion "should be exercised with appropriate regard for the fact that unless a life tenant gets cash he does not get anything in the here and now." 276 N. Y. 101, 115.

[5] See same case on rehearing, 282 U. S. 187, and Sauer *v.* New York, 206 U. S. 536, 546; Leathe *v.* Thomas, 207 U. S. 93; Vandalia Railroad Co. *v.* Indiana, 207 U. S. 359, 367; Enterprise Irrigation Dist. *v.* Farmers Mutual Canal Co., 243 U. S. 157, 164; Ward *v.* Love County, 253 U. S. 17, 22; Fox River Paper Co. *v.* Railroad Commission, 274 U. S. 651, 655. Compare United Fuel Gas Co. *v.* Railroad Commission, 278 U. S. 300, 307; Risty *v.* Chicago, Rock Island & Pacific Ry. Co., 270 U. S. 378, 387.

The executive committee of the Surrogates' Association of the State of New York, composed of the judicial officers immediately charged with application of these decisions to the instruction of and accountings by trustees held a similar view of the discretion left to trustees. The legislature appears to have been of the same mind in adopting the new legislation.[6] The judicial effort was to formulate general rules to guide fiduciary discretion. The *Chapal* decision was rendered in response to a trustee's petition for instructions. But while such decisions were useful as prece-

[6] When it was introduced into the legislature, the bill proposing § 17-c carried the following explanatory note by the Surrogates' Association:

"This amendment is proposed by the executive committee of the Surrogates' Association of the state of New York. Its general purposes are:

"(1) To simplify the complicated rules restated in Matter of Chapal (269 N. Y. 464) and in Matter of Otis (276 N. Y. 101) relating to mortgage salvage operations (a) in existing trusts as to mortgages hereafter acquired as a trust investment and (b) in testamentary trusts created by the will of decedent dying after its enactment and (c) in *inter vivos* trusts created by an instrument executed after its enactment. Such simplification is provided in the first subdivision of the new section.

"In recent years section 17-a of the Personal Property law was enacted to avoid the difficult problems of the allocation of stock dividends received during the period of a trust. Under that section they are now allocated wholly to capital. Section 17-b of the Personal Property law was enacted to abolish the intricate rule in Matter of Benson (96 N. Y. 499) under which it was necessary to capitalize the income on monies held within the estate for the payment of administration expenses, debts, taxes and pecuniary legacies. In line with this policy the proposed legislation contained in the first subdivision abolishes in the instances stated above, the Chapal-Otis rules, and will substitute a simple form of the treatment of the foreclosed real property as a principal asset of the trust. It is to be treated just as a railroad bond upon which default in interest before sale has occurred.

"(2) Further modifications are proposed by the second subdivision of the section as to mortgage investments already made in existing trusts. The present rules for apportionment between life tenant and remainderman under the Chapal-Otis cases are continued as to existing trusts where the investment in a mortgage has been made, with modification thereof in two specific instances.

"(a) The Chapal-Otis rule authorizes the trustee to pay surplus net income in his discretion. Trustees have hesitated to pay such net income because in the case of overpayment to the life tenant, the trustee might be surcharged with that amount. The life tenant of the trust must wait in the majority of cases for a long period of time before he becomes entitled to the payment of any income, because of the present requirement that advances from principal for the expenses of foreclosure and for arrears of taxes and other liens must first be paid from the net income of the property. The amendment provides for the immediate payment of income to the life tenant beginning with the date of the acquisition of the property by the trustee by foreclosure or conveyance in lieu of foreclosure. Under the new provisions net income up to three per centum of the face amount of the mortgage is so payable. Under the Chapal-Otis rules the life tenant is entitled in the final apportionment to the inclusion of interest at the mortgage rate during the period of the salvage operation. The rate of three per centum in the new section has been recom-

dents, they were felt not adequate to protect trustees against the hazards of litigation in particular cases, and the avowed effort of the court to adapt the law to the situation resulting from the depression failed in practice.[7] Hence the legislature intervened, adopted a rule which the trustee might have applied before, in its discretion, and prescribed it as a definite standard for setting apart income, protecting trustees against liability to remaindermen if they followed it. What appears really to have been taken from the remainderman is his right to question the equity of the rule in his indivjdual circumstances, a right which he had while it was a rule of the court. In the case of the *Sehnitzler* trusts where the rule results in invasion of the remainderman's principal to make good to the life beneficiary the statutory allowance of income, Surrogate Delehanty implied, and no one has de-

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mended as a fair return to the life tenant and at the same time a protection to the remainderman in the event that the property is sold at less than the face amounts of the income and principal shares employed as the ratio of the apportionment. (b) Surplus net income above three per centum is to be applied to the payment of advances from principal until the amount of such advances are satisfied. When the property in the salvage operation is sold, the unpaid balance of principal advances must be satisfied first out of the cash received from the sale. If there be any unpaid balance due for principal advances, it is made a primary lien upon the purchase money mortgage. The amendment further directs that after principal advances have been paid, the surplus net income above three per centum, accruing during the salvage operation, shall be held by the trustee to await sale and apportionment under the Chapal Otis rules." N. Y. Laws 1940, p. 1181.

[7] Surrogate Foley in the *Demorest* case states the effect of this Act as follows (Matter of West, 175 Misc. 1044, 1048):

"Two relatively simple modifications of the *Chapal-Otis* rules were made in this subdivision. Under those rules and particularly under the language of the opinion of Judge Loughran in *Matter of Otis* (*supra*), a discretionary power was given to a trustee during a mortgage salvage operation to disburse income to the life tenant, after advances made from principal as an incident to the acquisition of the property had been repaid. It was found, however, that trustees hesitated to make any payment to the life tenant or to exercise the judicial discretion given to them by *Matter of Otis*, because of the fear of a possible surcharge in the event of an overpayment to the life tenant. The life tenant in almost every instance was the primary object of the testator's bounty. The beneficiary intended to be most favored was thus deprived, by the trustee's inaction or hesitancy, of receiving income during the entire salvage period and large sums of money were accumulated and frozen. The injustice to the life tenant was aggravated by the fact that because of the lack of a ready market for the resale of the property, the salvage operation was unduly extended for a long period of years. This situation is emphasized by the facts revealed in the present proceeding. Of the seven mortgages now involved in the salvage operations in which no resale has taken place, the longest period of operation has been six years and two months. The shortest period has been four years and ten months. Thus the average period of operation of all seven mortgages has been approximately five years. In the two completed operations the periods of salvage were two years and six months and two years and eight months. This unhappy situation has been

nied, that the flexibility of the former rule would probably have resulted in a surcharge of the trustee's accounts, and hence that the remainderman has been deprived of the value which benefit of the *Chapal-Otis* rule would likely add to his remainder. Of course the very purpose of the statute, as Surrogate Foley points out, is to deprive him of that objection to the accounts, to protect the trustee against that hazard, and to give the remainderman other compensatory advantages. The legislature has furthered certainty at cost of flexibility.

Constitutional validity of this legislation if it had been made applicable to estates of decedents dying after its enactment is not questioned. It is objected only that application to an estate whose administration began before the Act so as to take away the remainderman's right to judicial examination of the trustee's computation of income makes it void for retroactivity.

It may be observed that insofar as appellants stand on the *Chapal-Otis* rule it can benefit them only if it may be retroactive. Both of these decedents died several years before either of those decisions. If a property right to some particular rule of income allotment in salvage proceeds vested at all, it would seem to have done so at death of the testator. If so, remaindermen would have to show that their property right was established by decisions then

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corrected by the new legislation. Trustees are expressly authorized to pay promptly net income derived from the foreclosed or acquired property up to three per centum per annum upon the face amount of the mortgage. From the time of the passage of the new act, it has been the practical experience and observation of the surrogates that hundreds of thousands of dollars which had been theretofore accumulated, were paid out to life tenants upon the authority granted by the statute. Where the trustee had paid the yearly income up to the three per cent maximum to the life tenant, the statute made the payment final. It was specifically stated by the Legislature that such payment up to the maximum was 'not subject to recoupment from the life tenant or as a surcharge against the trustee or executor.' Moreover, under the new statutory rule, net income up to the maximum of three per cent became payable from the very beginning of the salvage operation, that is, from the date of acquisition by foreclosure or by deed in lieu of foreclosure.

"The other amendment to the *Chapal-Otis* rules made by the second subdivision of the new section in the balancing of the equities, furnished protection to the remaindermen interested in the principal of the trust. Excess net income earned in any one year during the salvage operation above the three per cent maximum payable to the life tenant, was directed to be applied to advancements from principal for arrears of taxes and other liens which accrued prior to the foreclosure or acquisition in lieu of foreclosure and to the cost of capital improvements. Where any balance of unpaid principal advances remained due at the close of the salvage operation, such balance was declared to be 'a primary lien upon the proceeds of sale and shall be paid first out of any cash so derived. If insufficient the balance shall be a primary lien upon any purchase money mortgage received upon the sale.'"

in existence, or else that advantages derived from a later judicial decision may not be repealed. The case comes to this: Appellants took remainders at a time when the rules by which to sequester their interests in proceeds from complicated operations to salvage property were so indefinite that several years later the Court made an effort to devise more definitive rules for the purpose. They were but partly successful, and a few years later the legislature made further and perhaps more authoritative and final rules. Comparing the later with the earlier effort, the remainderman in these particular cases finds himself prejudiced. He says we must confirm him in the earlier by striking down the later of two retroactive rules of law.

This statute does not purport to open accountings already closed or to take away rights or remainders judicially settled under the old rule. The statute is applied only to judicial settlements pending at or instituted after its enactment. Rights to succession by will are created by the state and may be limited, conditioned, or abolished by it. *Irving Trust Company* v. *Day*, 314 U. S. 556. The whole cluster of vexatious problems arising from uses and trusts, mortmain, the rule against perpetuities, and testamentary directions for accumulations or for suspensions of the power of alienation, is one whose history admonishes against unnecessary rigidity. The state may extend the testamentary privilege on terms which permit tying up of property in trust for possibly long periods. But the state on creation of such a trust does not lose power to devise new and reasonable directions to the trustee to meet new conditions arising during its administration, such as the depression presented to trusts holding mortgages. Cf. *Home Building & Loan Association* v. *Blaisdell*, 290 U. S. 398. Nothing in the Federal Constitution would warrant us in holding that judicial rules tentatively put forward and leaving much to discretion will deprive the legislature of power to make further reasonable rules which in its opinion will expedite and make more equitable the distribution of millions of dollars of property locked in testamentary trusts, even if they do affect the values of various interests and expectancies under the trust. The Fourteenth Amendment does not invalidate the Act in question.

Affirmed.

Mr. Justice DOUGLAS, with whom Mr. Justice BLACK concurs.

The New York Court of Appeals stated that in formulating the statutory rule in question the state legislature did no more "than direct a trustee to do what under the decisions of this court he has discretionary power to do." 289 N. Y. 423, 430. And it went on to say, "Before the enactment of this statute, the life tenant could not have demanded as of right the payment to him during liquidation of more of the surplus income than he will receive under the statute. Neither does it appear that the remaindermen could properly have insisted that the trustee should be surcharged if in the exercise of his discretion he had paid to the life tenant the amount which the statute now directs." *Id.* That is a question of New York law on which the New York court has the final say. It is none of our business—whether we deem that interpretation to be reasonable or unreasonable, sound or erroneous. *Sauer* v. *New York*, 206 U. S. 536, 545-548. And there is no suggestion here that state law has been manipulated in evasion of a federal constitutional right. *Fox River Paper Co.* v. *Railroad Commission*, 274 U. S. 651, 657; *Broad River Power Co.* v. *South Carolina*, 281 U. S. 537, 540. Consequently I can see no possible claim to substantiality of any federal question, whatever view may be taken of the due process clause. I would therefore dismiss the appeal.